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C O N F I D E N T I A L OTTAWA 3910

E.O. 11652: GDS

TAGS: ETRD, CA

SUBJ: ECONOMETRIC STUDY OF CANADA-U.S. AUTO PACT

REF: OTTAWA 3437

1. THE ECONOMIC COUNCIL OF CANADA HAS JUST PUBLISHED
A STUDY BY DAVID A. WILTON OF GUELPH UNIVERSITY ENTITLED:
AN ECONOMETRIC ANALYSIS OF THE CANADA-UNITED STATES
AUTOMOTIVE AGREEMENT. DEGREE OF COVERAGE OF STUDY IN
CANADIAN FINANCIAL PRESS WAS SIGNIFICANT.

2. STUDY REPRESENTS FIRST ATTEMPT TO MEASURE SYSTEMATICALLY
THE GENERAL EQUILIBRIUM EFFECTS OF THE AUTO AGREEMENT
ON THE ENTIRE CANADIAN ECONOMY IN TERMS OF GROWTH RATES,
EMPLOYMENT GENERATION, INVESTMENT EXPENDITURES, PRODUCTIVITY,
FACTOR SHARES, INFLATION AND THE BALANCE OF PAYMENTS.
IN ADDITION, STUDY CONTRASTS EFFECTS OF AUTOMOTIVE AGREE-
MENT WITH ALTERNATIVE INDUSTRIAL STRATEGY WHICH GOVERN-
MENT MIGHT HAVE PURSUED IN LIEU OF AUTOMOTIVE AGREEMENT.
COSTS AND BENEFITS TO CANADA OF AUTOMOTIVE AGREEMENT
ARE ANALYZED IN CONTEXT OF BOTH PASSIVE GOVERNMENT
ROLE (I.E. NO SPECIFIC, ALTERNATIVE, COMPENSATORY
POLICY) AND AN ACTIVE ALTERNATIVE INDUSTRIAL
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POLICY DESIGNED TO OFFSET ANY POTENTIAL SHORTFALL

IN CANADIAN OUTPUT AND EMPLOYMENT.

3. COUNTERFACTUAL ANALYSIS IN STUDY IS BASED ON COMPUTER SIMULATION EXPERIMENTS USING A VERSION OF CANDIDE MODEL OF CANADIAN ECONOMY, MODIFIED TO ACCOUNT FOR STRUCTURAL RELATIONSHIPS IN THE CANADIAN AUTOMOTIVE SECTOR.

4. ON ASSUMPTION OF NO SPECIFIC ALTERNATIVE GOVERNMENT POLICY, STUDY INDICATES THAT THE AUTOMOTIVE AGREEMENT HAD FOLLOWING EFFECTS ON THE CANADIAN ECONOMY FOR 1971:

A. REAL GROSS NATIONAL EXPENDITURE (GNE) WAS OVER 5 PERCENT HIGHER THAN IT WOULD HAVE BEEN WITHOUT AUTO AGREEMENT;

B. TOTAL EMPLOYMENT WITHIN THE CANADIAN ECONOMY INCREASED BY ALMOST 4 PERCENT;

C. THE GENERAL RATE OF INFLATION DID NOT APPRECIABLY CHANGE ALTHOUGH RETAIL AUTOMOBILE PRICES DECLINED BY 12 PERCENT;

D. WHILE LARGE INCREASES IN CORPORATE PROFITS (8.8 PERCENT) AND IN TOTAL WAGES, SALARIES AND SUPPLEMENTS (6.5 PERCENT) OCCURRED, REAL WAGES PER EMPLOYEE ONLY MODERATELY INCREASED (2.6 PERCENT);

E. REAL GROSS CAPITAL STOCK IN CANADIAN ECONOMY marginally increased (1.3 PERCENT);

F. THERE WAS A STRONG FAVORABLE EFFECT ON THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS.

5. FINAL CHAPTER OF STUDY COMPARES IMPACT OF AUTOMOBILE AGREEMENT WITH ALTERNATIVE INDUSTRIAL POLICY IN MANUFACTURING SECTOR TO ACHIEVE SAME SIMULATED LEVEL OF OUTPUT AND EMPLOYMENT AS THAT ACHIEVED UNDER THE AGREEMENT. ACCORDING TO THIS SIMULATION, THE
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AUTO PACT GENERATED AN ADDITIONAL \$300 MILLION OF REAL OUTPUT AND 80,000 MORE JOBS THAN ALTERNATIVE INDUSTRIAL POLICY. MORE IMPORTANTLY, THE AUTOMOTIVE AGREEMENT TRANSFORMED THE LARGE SIMULATED DEFICIT ON THE CURRENT ACCOUNT TO A \$200 MILLION SURPLUS FOR THE YEAR 1971. THE ALTERNATIVE NEW INVESTMENT POLICY SIMULATION SUBSTANTIALLY INCREASED THE EXISTING CURRENT ACCOUNT DEFICIT TO A LEVEL EXCEEDING

\$2 BILLION FOR THE SAME YEAR. STUDY CONCLUDES THAT AUTOMOTIVE AGREEMENT, WHICH GREW OUT OF BALANCE-OF-PAYMENT CONCERNS, GENERATED A SUBSTANTIAL IMPROVEMENT IN THE CANADIAN TRADE BALANCE DURING THE 1965-1971 PERIOD.

6. AUTHOR CITES FOLLOWING WEAKNESSES OF THE STUDY:

A. POSSIBLE DEFICIENCIES OF SPECIFICATION IN THE MODEL;

B. MODEL DOES NOT ACCOUNT FOR REGIONAL DIFFERENCES IN IMPACT OF AUTO AGREEMENT WHICH IS PARTICULARLY IMPORTANT IN LIGHT OF HEAVY AUTO INDUSTRY CONCENTRATION IN ONTARIO;

C. LACK OF A COMPARABLE STUDY OF THE IMPACT OF THE AGREEMENT ON THE UNITED STATES;

D. STUDY COVERS ONLY FIRST SEVEN YEARS OF EXPERIENCE WITH THE AGREEMENT AND THUS DOES NOT ADDRESS LAST FIVE YEARS WHICH HAVE BEEN LEAN ONES FOR THE INDUSTRY.

7. COMMENT: EMBASSY OFFICER DISCUSSED STUDY WITH INDUSTRY TRADE AND COMMERCE (ITC) OFFICIAL WHO GENERALLY DISPARAGED VALUE OF STUDY AND MADE FOLLOWING CRITICAL OBSERVATIONS REGARDING ITS FINDINGS:

A. STUDY OVERLOOKS MOST RECENT EXPERIENCE WITH THE AGREEMENT WHICH "HAS BEEN JUST THE REVERSE" OF THAT IN PERIOD COVERED BY STUDY (A WEAKNESS ACKNOWLEDGED BY THE AUTHOR);

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B. PUBLICATION OF STUDY BY ECONOMIC COUNCIL OF CANADA AT THIS TIME IS UNFORTUNATE BECAUSE FINDINGS, WHICH ARE SUBJECT TO VARYING INTERPRETATION, WILL ONLY EXACERBATE POLITICAL CONTROVERSY SURROUNDING THE AGREEMENT;

C. STUDY'S MACRO APPROACH OVERLOOKS PROBLEMS OF INDIVIDUAL FIRMS, ESPECIALLY WEAKER ONES WHOSE POSSIBLE DEMISE WOULD HAVE SIGNIFICANT IMPACT ON STRUCTURE OF AUTOMOTIVE SECTOR AND CREATE SERIOUS POLICY PROBLEMS FOR GOVERNMENT OF CANADA.

8. EMBASSY BELIEVES ITC OFFICIAL'S CRITICISM OF STUDY REFLECTS CONCERN THAT ITS GENERALLY POSITIVE ASSESSMENT OF AUTO PACT MIGHT REDUCE CREDIBILITY OF FORTH-

COMING ITC PORTION OF JOINT CANADA-U.S. AUTO INDUSTRY STUDY, WHICH AS EMBASSY REPORTED IN REFTEL, WILL ILLUMINATE SERIOUS PROBLEMS THAT SOME CANADIAN AUTOMOTIVE FIRMS, PARTICULARLY PARTS MANUFACTURERS, ARE EXPERIENCING AS A RESULT OF THE AGREEMENT.

9. EMBASSY IS TRANSMITTING COPIES OF THE STUDY BY AIRGRAM.
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